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THE SOUTH WEST ECONOMY AND THE "1992" INTERNAL MARKET: SOME TENTATIVE PREDICTIONS OF A GENERAL AND A SPECIFIC NATURE

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There has occurred a growing, if somewhat belated, recognition of the possible regional impacts of the planned further liberalisation of the trading regime within the European Community (EC). This process of liberalisation, the Internal Market programme, will have significant effects, not only on the national economy of the UK but also on the South-West economy.

This discussion paper will:

1. Outline the nature and content of the Internal Market liberalisation programme. The impact of '1992' on the EC macroeconomy and microeconomy is analysed. The European Commission has recently produced a wide array of Community-wide macroeconomic, microeconomic and sectoral studies (European Economy (1988) & Cecchini (1988)).

2. The nature of the impact of '1992' on the South-West regional economy is considered at the general, and the specific levels.General implications for 'peripheral' regions are highlighted and tentative specific implications, for the South-West, are hypothesised. Comprehensive regional studies of the impact of the Internal Market are strikingly absent. An attempt is made to identify certain regional implications from the Communitywide and sectoral studies setting out the probable impacts.

3. Given the economic structure of the South-West and the nature of the Internal Market liberalisations a number of industrial and service sectors are identified as potential beneficiaries in the development of the Internal Market.

1. Introduction to the '1992' Internal Market Liberalisation Programme

In 1985 the European Commission, the policy initiator of the European Community (EC), published a Community White Paper entitled 'Completing the Internal Market' (Commission of the European Community, 1985). The intention of the White Paper was, and still is, to set out the requirements for the creation of a European Domestic Market. Please note that the terms Internal Market, Single Market and European Domestic Market are used interchangeably.

The Internal Market, "a market without internal barriers", is seen by the European Commission as **'the'** way to regenerate Europe as a credible force to stand against the economic might of both Japan and the USA. Without the integrating impetus provided by the Internal Market the Member States will remain, it is argued, a fragmented, vulnerable 'ailing economic alliance'. The EC might become a twentieth century equivalent of Burke's description of eighteenth century Spain- "a whale stranded on the coast of Europe"- with "Europe a whale stranded on the coast of Asia" (Leonard, 1988).

Cecchini (1888) argues that the completion of the Internal Market "... is not only the key to the Community's prosperity, it is the key to the Community's future." The European Community has grown slowly and has suffered higher unemployment than the USA and Japan- achieving less than half the growth of Japan and two-thirds of the growth of the USA over the period 1975 to 1987.Over the same period unemployment, within the EC, has been twice that of the USA and four times that of Japan. See European Economy (1988) for a detailed review of the poor economic performance of the EC compared to the 'opposition'.

Creating the Internal/Single Market involves the dismantling of a wide variety of 'non-tariff barriers' to the free flow of trade in goods and services within the EC. The Internal Market will not, of course, happen overnight. "1992 is a process not a date. It is a programme and a strategy" (Cecchini, 1988).

The 'creation' of the Internal Market will involve the removal of border formalities and controls, the liberalisation of public procurement, the harmonisation of technical standards, the liberalisation of the financial service sector and the 'approximation' of indirect taxation. Some 285 measures, at the latest count, constitute the building blocks of the 'new Europe' without internal frontiers.

The removal of the internal frontiers will create a single domestic market able to compete effectively with the economic giants- the USA and Japan. Whether, or not, 'big' actually means 'beautiful' has not been established Cecchini believes that it has. Big markets and big enterprises are the twin objectives. The Internal Market will 'giantise' the EC.

The 'completion' will 'Open Europe for Business'- at least so the advertising slogans go in the UK. Simultaneously, of course, the 'completion' will 'Open Britain for Business'. The UK balance of payments, vis-a-vis the rest of the Community, has consistently in deficit.. Prior to Britain joining the EC, in 1973, the UK ran a surplus. Even Mrs. Thatcher recognises that, so far, Britain has "not done very well in Europe." Will the UK balance of payments with the rest of the Community go further in the red?

The barriers to be abolished by the full Internal Market programme have two basic effects. Firstly, they 'increase' the cost of getting into other Member States' markets and, secondly, they 'restrict' the access possibilities, by way of a variety of restrictions and limitations, of getting into other Member States' markets.

The cost of getting into a Member State's market can be increased by way of State 'subsidisation' of the domestic producer and/or by imposing extra costs on the non-domestic producer. One example of such a 'cost imposing' EC policy is the regulation of road haulage. Unnecessarily high transport costs discourage trade.

Time spent at customs posts, in order to check on compliance with tax assessments and verification of technical regulations, is afar from costless exercise. To the extent that differing national requirements exist, marketing and packaging costs will increase to comply with these national differences. Public procurement discrimination limits the ability of non-domestic EC sources to 'penetrate' domestic markets. The service sector suffers greatly from limitations on cross border trade and from the existence of controls on rights of establishment. Licensing procedures harness the extent of intra-Community trade in air transport. These limitations on the free movements of goods and services are but a sample of the 285 restrictions that are to be swept away by the 'full blown' Internal Market programme.

The barriers act as 'frontiers to trade' which 'fragment' the markets of the EC economy. Trading niches are created which tend to be inhabited by the domestic producers. To an extent Europe is not fully Open for Business'! The hope, of the European Commission, is that by 31st. December 1992 Europe will be completely open for business.

The sum of the costs of the present barriers are referred to as 'the costs of non-Europe'. The Internal Market programme will remove these barriers, lead to reductions in costs (and prices), enhance productivity and efficiency The efficient will prosper whilst the inefficient will have to mend their ways or go under. Production facilities will be rationalised and location decisions re-evaluated. Unambiguously the 'Euro-consumer' will benefit, whereas the outlook for 'Euro-producers' is inevitably mixed. Benefits can only accrue if the necessary costs are incurred. "Rich pickings are to be earned, not inherited" (Cecchini, 1988).

If the programme is fully implemented then there will be substantial effects on the EC macroeconomy and microeconomy. The likely specific impacts on the UK economy, in general, and on the South-West economy, in particular, are not known. These impacts are, in a sense, unknowable. If the rich pickings have to be earned not inherited then the answer is unknowable- it all depends on the responses made, the reactions to, the new competitive environment.

Clearly the Internal Market programme will probably generate some kind of regional and/or national imbalances. Modest "accompanying measures" are envisaged by the Council of Ministers but little is heard of these. These measures are, in effect, a co-ordinated reflationary exercise by the Member States of the EC exploiting the exchequer funds thrown up by the Internal Market programme, are required to bring into rough equality the growth rates of the Member States and foster reductions in the differential rates of unemployment. These meassures, to an extent, recognise the importance of the 'social dimension' of the Internal Market.

Cecchini (1988) is notably silent on this facet of the Internal Market. Indeed, for some, this is perfectly appropriate. The radicalisation of the Community marketplace is surely at odds with the socialisation that the 'accompanying measures' require.Can one have more market and more state? The economic facet of the Internal Market proceeds whilst the social facet awaits future developments.

If the 'social' accompanying measures are not in place, to pick up the pieces created by Community-wide rationalisations, then post-1992 Europe may not be much fun for certain 'peripheral' regions. Without adequate structural funds and industrial and social policy the Internal Market could well turn out to be something of a 'bum deal'. How are the 'imbalances' to be rebalanced'? Additionally the political divergence, present in many Internal Market issues, and the consequent lack of progress on that sub-set of the 285 measures, might mean that the opening up of Europe actually fails to materialise. to time and to specification

2. The Impact of the Internal Market on the United Kingdom Economy

The major study of the benefits of the Internal Market programme- 'The Costs of Non-Europe' (Cecchini, 1988) provides an invaluable honey pot of information on the possible/probable consequences of the Internal Market. Cecchini commissioned a wide range of detailed research, the results of which are now becoming available. An accessible review of the major findings of this work is available in the March edition of European Economy (1988).

Cecchini's analysis of the benefits of 'de-fragmenting' Europe is a massive piece of work. Neuberger (1989) asserts, and then demonstrates, that the result is, in fact, a "disgrace to the economics profession" replete with "elementary blunders". The aim of Cecchini was to establish that the **sole** cause of the poor performance of the EC was its 'fragmentation' caused by the existence of a variety of internal barriers to trade.

Two approaches to the measurement of the gains of 'defragmentation' are presented by Cecchini- the macroeconomic and the microeconomic. The domain of the macroeconomic extends to such aggregates as jobs, growth, the balance of payments and exchequer balances. In general the achievement of one target will compromise the achievement of another. In the case of the Internal Market no such compromises are evident.- according to Cecchini! The Internal Market 'dominates' the alternative 'fragmented' Community.

However the microeconomic domain is inhabited by considerations of envisaged cost reductions. Cost reductions are not unambiguously a good thing. Cutting costs means less employment, wages or profits. In macroeconomic terms reductions in employment are a 'good thing' whereas from a macroeconomic perspective such reductions are 'bad'. In a real sense the microeconomic analysis does not 'complement' the macroeconomic analysis. The presumption that surplus resources will be re-empolyed is hardly warrented!

In terms of 'global' effects significant increases in income and employment, and significant reductions in prices, are expected.Balance of payments constraints are to be eased and exchequer coffers are to be swollen. Details of the global impacts of the Internal Market are summarised in Figure 1.

FIGURE 1:
DIRECT MEDIUM TERM MACROECONOMIC IMPLICATIONS OF EUROPEAN COMMUNITY INTEGRATION: WITHOUT ACCOMPANYING MEASURES

	Total Value %	Total Range Of Effects %
Relative Changes:		
% GDP	+4.5	+(3.2 - 5.7)
% Consumer Prices	-6.1	-(4.5 - 7.7)
Absolute Changes:		
Budget Balance (%GDP)	+2.2	+(1.5 - 1.3)
External Balance (%GDP)	+1.0	+(0.7 - 1.3)

Source: Cecchini (1988)

Cecchini argues that if the 'proceeds' of the Internal Market are used wisely- that is Member States co-operate and 'co-ordinate' the 're-investment' of the 'exchequer proceeds'. The 'basic' benefits are enhanced by the 'accompanying measures'. Employment and income grow even more etc. etc.. Details are in Figure 2.

FIGURE 2:
MACROECONOMIC IMPLICATIONS OF EUROPEAN COMMUNITY INTEGRATION

Economic Policy Options	Increased: Output %GDP	Employment Millions	Budget Surplus %GDP	External Surplus %GDP	Reduced: Prices %
Without Accompanying Measures:					
	+4.5	+1.8	+2.2	+1.0	-6.1
With Accompanying Measures:					
1. Balancing Public Budgets					
	+7.5	+5.7	0.0	-0.5	-6.1
2. Balancing External Account					
	+6.5	+4.4	+0.7	0.0	-4.9
3. Hybrid Policy Option					
	+7.0	+5.0	+0.4	-0.2	-4.5

Source: Cecchini (1988)

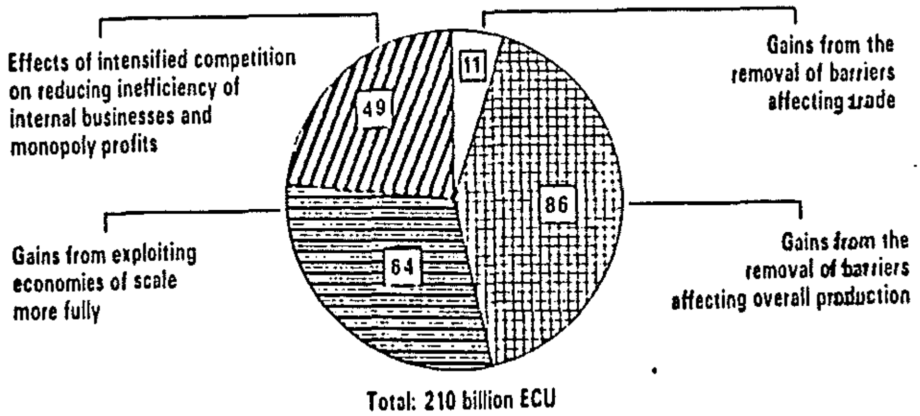
The 'hybrid' option allocates the additional EC national exchequer resources in such a way that neither the budget surplus nor the external account is pushed to the 'balancing' limit. As such output rises less than in the first 'scenario' but public budget remains in surplus. Likewise, with respect to the external accounts, the overall deficit in scenario 3 is less than in the second scenario. The cost of this option is generally fewer jobs created, less growth in EC output and prices being reduced to a lesser extent.

Do the reductions benefit the 'rich' or the 'poor'? Of course, as a 'generalised' Euro-consumer, such reductions are a good thing.The benefit to the consumer is a loss to the producers. Is such a 'transfer' necessarily a good thing? What is really needed, argues Neuberger, is a comprehensive cost benefit analysis of the Internal Market.Certain Some limited CBA-type studies were conducted within the Cecchini programme of study. It is the case that only if the savings in resources- the cost reductions- are re-employed can a benefit be presumed to exist. A potential exists but no more.

The closing down a UK coal mine, to make coal production more efficient, may, in fact, generate a 'social loss' for the EC. If the EC is dogged by massive unemployment can one safely assume that those resources 'freed' by more efficient production will be re-employed? The belief, nay conviction, of Cecchini is that such re-employment will take place.

The EC will become more self-sufficient and, subsequently, will perform better in external markets. The resources freed, in the microeconomic domain, are presumed to be employed in the macroeconomic domain. A breakdown of the microeconomic gains by the nature of origin is presented in Figure 3.

FIGURE 3:
ESTIMATES OF THE POTENTIAL MICROECONOMIC GAINS OF THE COMPLETION OF THE INTERNAL MARKET (Central Estimates ECU bn. 1988 Values)



Source: Cecchini (1988)

"The central argument of the Cecchini studies is that the liberating market will be the salvation of Europe. In fact the studies show that it is government action which will be the salvation of Europe" (Neuberger, 1989). What really creates the jobs and income in post-1992 EC are the 'accompanying measures' that are made possible by the extra public revenues created by the basic Internal Market measures. The 1.1 million jobs turn into 5.7 million and the 4.5% growth turns into 7.5%. Without the 'accompanying measures' the Internal Market will consume jobs until the sixth year of the programme. Will the 'accompanying measures' be forthcoming? The Internal Market programme is an uneasy alliance between the market and the state!

Regional studies of the likely/possible effects of the Internal Market programme are virtually non-existent. A search through relevant journals has uncovered only two such analyses (Smith &Venables (1988) and Gibb & Treadgold (1989)). It was only in September 1989 that the European Commission launched two studies on the regional implications of the completion of the Internal Market of, firstly, the opening up of public procurement in the water, energy, transport and telecommunications sectors and, secondly, in respect of the liberalisation of financial services (European Commission, 1988).

An explanation of this situation could be that the 'hype' surrounding the Internal Market programme has caused attention to be concentrated on the benefits of the programme. Costs there will be and some of these costs will be of a regional nature.Regional implications are therefore difficult to assess. If, as is recognised by Lord Cockfield (1988), the economy of the EC will become "more concentrated and more specialised with fewer but larger companies" then to assume that the effects will be spread equally is unacceptable. Cockfield believes that "it is wrong to assume that the benefits would be concentrated in the industrial north of the Community". The leader, in the same issue of the Financial Times, is more realistic. "Harsh dislocations and short term job losses" are the more likely consequences of Internal Market rationalisations whatever the longer term 'multiplier' effects of the initial economic expansion".

The extent of the existing regional economic disparities cannot be denied. The European Commission (1987) noted the "renewed confirmation of the wide disparities between the regions". These disparities had grown during the 1970's and 1980's. The enlargement of the EC, with new members joining at the bottom of the economic league table, has excacerbated the situation. Portuguese GDP per capita is only 50%, and Spanish GDP per capita 77%, of the corresponding figure for EUR10. The virtual halt in inter-Member migration has also played its part in the growth of regional economic disparity. Figure 4 gives some details. Compared with the USA regional income disparity is twice that of the USA and regional unemployment disparity thrice that of the USA.

FIGURE 4:
DISPARITY OF REGIONAL GDP PER CAPITA (1985)

Member States:	Maximum	Minimum	Mean	Coefficient of Variation:	Theil Coefficient: (*100)
West Germany	200	81	121	18.7	0.73
France	170	85	113	25.1	1.25
Italy	136	54	91	24.7	1.37
Netherlands	116	79	105	13.4	0.39
Belgium	137	83	109	17.6	0.67
Luxembourg	-	-	127	-	-
UK	149	82	102	18.2	0.65
Ireland	-	-	69	-	-
Denmark	147	107	125	12.8	0.35
Greece	60	43	56	8.6	0.17
Spain	98	47	77	18.7	0.78
Portugal	-	-	50	-	-
EUR 12	158*	51*	100	28.5 (18.7)	1.73 (0.82)

Source: EUROSTAT estimates

Notes: Coefficients outside brackets refer to total disparity between the regions of the EC. Coefficients inside brackets refer to disparity at the country level.

* Averages of the highest 10 and lowest 10 Regions within EUR 12.

2.1 Impacts on Industrial Sectors

Which UK industrial sectors might be affected? A study (Hughes,1986) of the importance of barriers to EC trade, in a variety of industrial products, put forward these two tentative conclusions:

a. The following sectors: motor vehicles, stone-clay-glass, paper-publishing and footwear-clothing-glass: reported few, if any, institutional barriers to trade within the EC. In effect these sectors already inhabit a 'mini-Internal Market'.

b. The following sectors: pharmaceuticals, chemicals, metals, food-drink, aerospace, computers and wood-cork-furniture: reported a very significant presence of institutional barriers to trade within the EC. These sectors are expected to expand as a result of Internal Market liberalisations.

Pelkmans (1986a) suggests that the importance of barriers to trade are greater the more 'high-tech' the industry. The small size of Pelkman's sample make statistical significance impossible to estimate. A further study of Pelkmans (1986b) indicates that it is the 'nature' of the barriers that change, rather than the 'number' that changes as one moves from the 'low-tech' to the 'high-tech' industry. 'High-tech' industries suffer by way of the nationalistic public procurement policies of buyers and the problem of access produced by divergent national standards requirements. Industries as telecommunications,pharmaceuticals and aerospace products. fall into this category. 'Low-tech' industries exhibit few barriers but are advantaged by the existence of a variety of state aids. The Pelkmans material suggests that, in general, the UK is 'doing well' in those areas, which at present,suffer the most barriers to trade. Pelkmans (1988) concludes that it could be expected that with the removal of the barriers the UK might do 'even better'.

On the other hand the 'relative success' of the UK in the 'high-tech' sector may simply reflect a particularly nationalistic set of public procurement policies operated by the UK public sector. Furthermore, past successes are not automatically converted into future successes. Indeed the comparative advantage enjoyed, within the EC apart from Germany, by the UK in 'high-tech' is increasingly under threat.

Trade in investment goods, in particular electrical and engineering goods, transport goods and precision and office equipment appears to be most affected by technical barriers- such as specification of 'essential requirements' and differences in standards- according to the 'opinion of experts' consulted by the European Commission. Industries were ranked by European Commission 'consultants', according to 'their' estimates of how badly the industries are affected by the existing range of non-tariff barriers. Figure 5 compares the importance of these barriers with Uk international trading performance, and implicitly, their comparative international efficiency.

The adoption of common standards for telecommunications equipment- within the electrical engineering sector- will affect the competitive environment for such equipment. The heightened competitive environment that currently exists within the UK could well enable British producers to take an early commercial advantage. The UK pharmaceutical industry operates with certain cost advantages. This is mirrored by the UK trading surplus, of 27%, enjoyed in pharmaceuticals. The food, tobacco and drink sector similarly enjoys cost advantages compared to Italy, France and Germany. Whether or not this advantage can be turned into further exports depends on the extent to which the 'rest' of the EC is able to 'harmonise tastes' on UK lines! Within the comparatively heterogeneous sector of precision and medical equipment the wide ranging differences in national standards requirements have produced a highly fragmented industry. The effect of the 'harmonisation of standards' will be to engender further trade. The UK, with its relative comparative advantage, may expect to 'earn' some relatively rich pickings.

Pelkmans (1988) points out that the 'current' UK share of world power generation equipment much exceeds the share of the UK within the EC. Presumably, with the liberalisation of public procurement practices in this sector, the UK should be well placed to increase its EC share.

The industries that benefit most, by state aid in the UK, are aerospace, motor vehicles and steel and shipbuilding. Much of the aid to aerospace arises from support for R+D. Such support,however, is likely to continue in the years beyond '1992'.

For the South-West, with a highly developed regional specialisation in aerospace, such an outcome would be encouraging. The regional concentration coefficient for the aerospace sector is 2.5. Employment in the South-West in this sector represents over 30,000 out of the total figure, for the UK, of about 168,000. Relaxation and liberalisation of public procurement practices could generate expanded sales for this sector with associated employment implications for the South-West.. With respect to the other sectors referred to reductions in aid are likely but, given corresponding reductions in the level of support in the rest of the EC, the net effect on the UK, of such reductions, is likely to be small. Exports from these sectors are, therefore, likely to expand.

FIGURE 5:
TECHNICAL BARRIERS AND REVEALED COMPARATIVE ADVANTAGE

	UK: Revealed Comparative Advantage
Barriers of Great Importance:	
Electrical Engineering	1.00 - 1.69
Mechanical Engineering	0.75 - 0.94
Pharmaceuticals	1.38
Food, Drink & Tobacco	1.38 - 1.56
Precision & Medical Equipment	1.50
Barriers of Medium Importance:	
Motor Vehicles	0.56
Non-Metallic Mineral Products	1.06
Metal Articles	0.82
Rubber Products	0.82
Office & Data Processing Equipment	1.56
Barriers of Low Importance:	
Chemicals (Non-Pharmaceuticals)	0.25 - 1.00
Other Transport Equipment	1.56
Leather & Leather Goods	0.82
Plastics	0.44
Production of Metals	0.63
Footwear & Clothing	0.25 - 0.69
Mineral Oil Refining	2.24
Paper, Printing & Publishing	0.69

Source: European Economy (1988) and OECD data. Reproduced from Lloyd's Bank Economic Bulletin (Number 101), January 1989.

Note: Revealed Comparative Advantage is measured by the share of UK exports in a particular sector in total EC exports in that sector. A ratio above unity indicates relative strength and vice versa. Where ranges are shown, this reflects differences in sub-sectors of the categories given.

With respect to the drinks sub-sector the effects of 'fiscal approximation' could be quite dramatic with the impact being largely domestic in nature. If current European Commission proposals are adopted then the market price of spirits in the UK could, possibly, fall by some 40%. Demand could rise considerably. Some calculations indicate that the consumption of whisky could rise by 40% in the UK. Exports to the northern-high duty members of the EC could be expected to rise strongly also. The original proposals have been resisted by certain Member States. Whether or not these excise duty proposals will be adopted is very uncertain. Significant changes in the price of tobacco products could well occur.

The industrial studies completed as part of the Cecchini programme generally make grim reading for the UK. Neuberger (1989) charts the probable consequences for the UK in those sectors presumed to be most affected by the Internal Market schedule- if the schedule is held to! Neuberger's main source is Smith and Venables (1988). Smith and Venables analyse the effects of the Internal Market on the number of companies in a variety of imperfectly competitive markets. See Figure 6 for details.

In all but one case the UK suffers a loss of production in spite of the fact that the level of production in the EC, as a whole, is predicted to rise. The effect on the UK balance of payments is, of course, negative as imports substitute for hown grown output. One fifth of the EC is British yet the overall benefit to the UK is about one eighth. Benefits arise to the UK as a result of the importation of cheaper non-UK sources exceeding the cost of lost production. Output effects are, in all cases but one, negative.What might be the regional impact of these losses?

FIGURE 6:
THE EFFECT OF REMOVING TRADE BARRIERS

	Output Change %		Economic Benefit ECU millions	
Industry:	UK	EC	UK	EC
Cement	-4.0	0.2	-7.9	-156.7
Pharmaceuticals	0.5	0.4	12.0	68.1
Office Machinery	-21.3	10.4	22.9	239.0
Electric Motors	-0.1	0.4	14.2	104.0
Artificial Silk	-6.7	4.2	5.0	56.7
Machine Tools	-0.2	1.7	12.6	62.4
Carpets	-12.0	2.4	5.5	52.2
Footwear	-15.0	3.2	.2	37.8
Electric Household Goods	-4.9	2.1	9.1	84.2
Motors	-0.5	3.4	110.8	950.6
Total:	-	-	188.4	1498.6

Source: Smith and Venables (1988)

Note: ECU stands for European Currency Unit. At May (1989) exchange rates 1ECU = £.66.

The rationalisations, that are highlighted by Smith and Venables are used by Cecchini's as part of the the basic argument that the 'fragmented' EC market is associated with 'sub-optimal' firm size and consequent scale inefficiency. Rationalisations are required in order that the EC can then compete with the 'giants' of the USA and Japan. But are not EC firms large already? From the Times

Thousand (1986) listing of those 95 firms with a turnover in excess of 10 billions 40 were European, 27 American and 28 were Japanese. Within the EC the largest firms tend to be commodity based rather than manufacturing based- as is the case in the USA and Japan. Within the manufacturing sector Europe dominates chemicals whilst the USA dominates aircraft.

Strangely, for Cecchini, large UK firms dominate the EC yet UK economic performance has generally been relatively poor. Company size is not necessarily associated with above average economic performance. Over the period 1975-1987 UK growth exceeded that of three EC partners- The Netherlands, Belgium and Spain. Whilst growth in the UK has been sluggish UK companies earn some 56% of total EC 'top' company profits. Size may be less important than the degree of 'modernisation' taking place within the EC. Bigger is not necessarily 'bolder', 'beautiful or better. Bigger may simply mean"torpid" (Neuberger (1989).

2.2. Impacts on Service Sectors

The UK has, and continues to have, considerable strength in the realm of the service sector.For example, with respect to banking services, banking is relatively more developed in the UK than in the EC and the business is already highly international. See Figure 7 for some details.

FIGURE 7:
BANKING ACTIVITY IN THE UK RELATIVE TO OTHER EUROPEAN CENTRES

	UK	Comparator Group	Comparison
Bank Assets (% GDP)	168%	101%	Mean: France, Germany, Italy
Foreign Liabilities (% Total Assets)	71%	19%	As Above
Finance/Insurance (% GDP)	7.4%	5.8%	Mean: Germany, US &Switzerland
Daily Turnover in Foreign Exchange	$90bn	$50bn $48bn	New York Tokyo

Source: Figures quoted in Pelkmans (1988) from various sources.

Note: Figures relate to 1987

Real value added per employee in banking and insurance is considerably higher than the major partners in the EC. The ratio of UK real value added per employee to German real value added per employee is approximately 1.5, for Belgium 2.2, for France 1.95 and for the Netherlands 2.2.

The largest single benefit of the single market is assumed to arise from the liberalisation of financial and business services.The size of the benefit is estimated to lie in the range 11-33 ECU billions. The basis of the estimated benefits is from a study of the 'post-Big Bang but pre-Black Monday' UK financial market. The price of financial services is presumed to converge 'downwards' on the average of the four lowest national prices within the EC for a range of financial services. Low cost supplier nations would expect no change in price levels.

Can price convergence be expected to take place without the convergence of interest rates? Without interest rate convergence financial services price convergence is likely to be limited-given the link between the two. In fact Cecchini (1988) does not require 'convergence' of interest rates. The savings, referred to,relate to the savings in costs that are additional to interest rate charges. Although the UK has great 'strength' in this sector the benefits to the UK financial services sector may simply take the form of the "re-organisation of continental auditing offices behind plates with new British or American names" Neuberger (1989). Higher profits for shareholders will produce a beneficial balance of payments effect but not necessarily more UK jobs.

The strength of UK financial services sector is reflected in the considerable net earnings on the current account of the balance of payments. Some relevant statistics are presented in Figure 8.

FIGURE 8:
UK FINANCIAL SERVICES BALANCE OF PAYMENTS NET EARNINGS

Balance of Payments Net Earnings:

Insurance Companies		1585mn.
Banking		2339mn.
Trading & Broking		1278mn.
Financial & Other Services Trade with EC (1984):	Exports:	2155mn.
	Imports:	1215mn.
Insurance, Finance & Business Services Trade (1986):	Exports:	2614mn.
	Imports:	686mn.
UK Share of World International Bank Lending (1986):		23.3%
Share of Insurance Premia Originating Abroad:		56.0%

Source: Figures quoted in Pelkmans (1988) from various sources.

The explanation of this pre-eminence is not a settled question. Factors such as the available pool of suitably skilled labour,the relatively liberal regulatory regime in the UK and the beneficial effects of weight of 'historical dominance' are but three putative explanations of the continuing effectiveness of the service sector. The coming liberalisation of EC service markets will tend to benefit the UK unless the advantage that the UK experiences is based simply on the fact that the UK has a 'head start' in terms of liberalisation. The relative expansion that has been taking place, in the service sector in the South-West augurs well for the post-1992 world.

Whether or not the services, referred to above, are able to exploit the financial environment of the EC, post-1992, depends on the genesis of the current advantage that clearly exists and the precise form of the liberalised service sector of the EC. The effects on the South West will tend to reflect,in general, the nature and extent of overall impact on the UK.

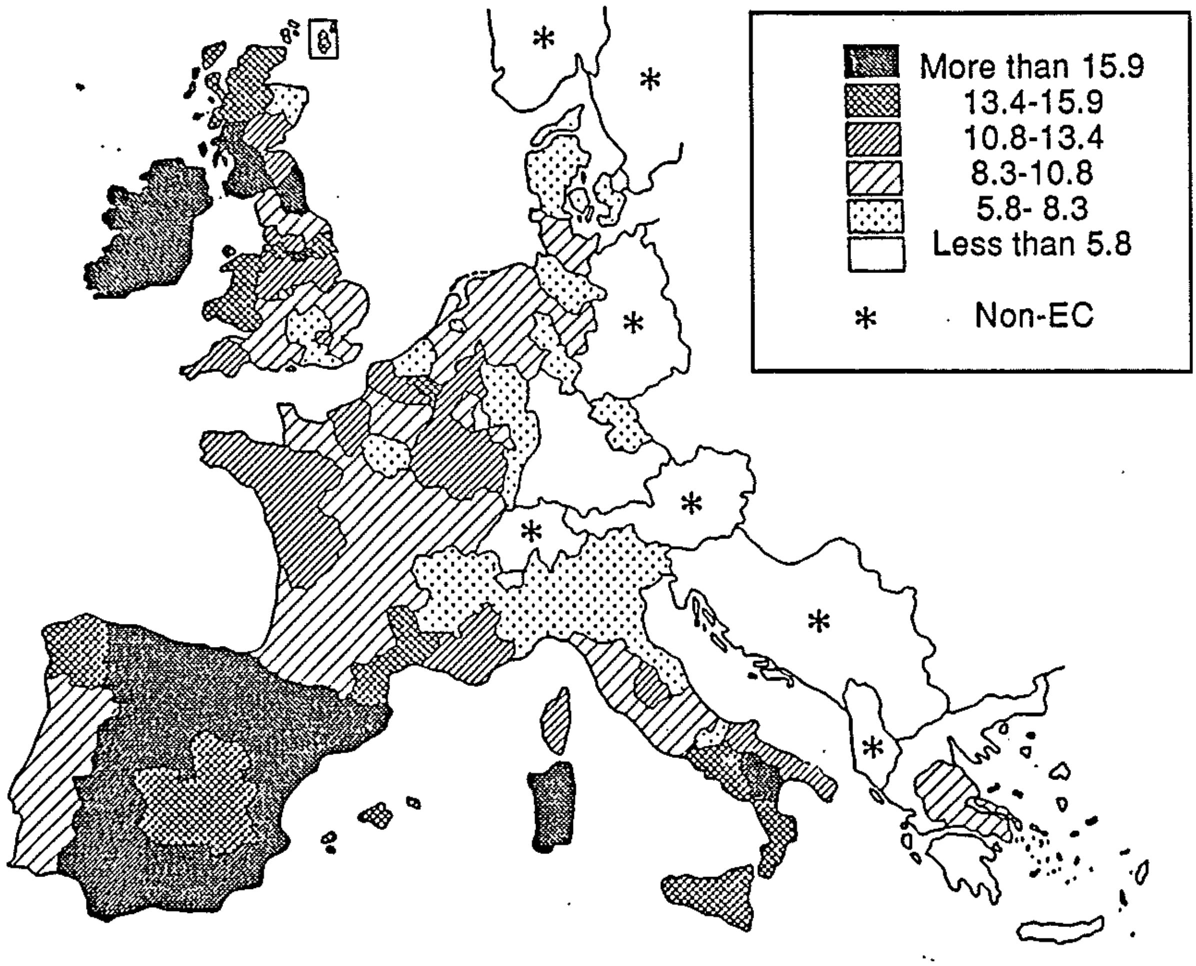
Cecchini's (1988) approach to the question of the assessment of the nature of cost savings was through a large scale opinion survey of the business community. The chief cost savings appear to be in respect of distribution costs. These costs include the saving of 'administrative time' incurred at frontiers, import costs and costs associated with meeting diverse national technical standards which exist within the EC. These direct cost savings would, if realised, facilitate easier access into EC partner markets. The European Commission estimates that the cost of the restrictions on road haulage is equivalent to 5% of turnover. Distribution costs are of particular significance to those sectors engaged in intra-Community trade.

The effect of the 'liberalisation' of road haulage and the easing of costs of frontier formalities lies behind the widely reported importance of distribution costs. The anticipated reductions in distribution costs are akin, in their impact, to the Channnel Tunnel.

3. Possible Impact of '1992' on the South-West Regional Economy

The Internal Market 'may' make the EC, on average, a richer place. But what of the possible distributional consequences of the Internal Market? Europe is already an unequal economic alliance- both between and within Member States. Consider unemployment rates throughout the EC.as shown in Figure 9. The UK is a really unequal Member State of the EC. Only Italy shows up with an equivalent degree of regional unemployment rate dispersion.

FIGURE 9:
REGIONAL UNEMPLOYMENT RATES IN THE EUROPEAN COMMUNITY (% 1986)



Source: Gibb & Treadgold (1989)

Cecchini asks the reader to consider the size of the Internal Market cake not the size of the slices. Fair dues! But at what stage do distributional considerations come up for consideration? Undoubtedly certain regions will suffer from the likely industrial and service developments and rationalisations that probably will, to a greater or lesser extent, take place as the Internal Market juggernaut rolls on. The Commission 'orthodoxy',whilst recognising the short term dislocations, believe that the 'diffusion' of wealth from the 'richer' to the 'poorer' regions.'Economic convergence' is to occur. It is, as if, wealth in the South-East will set off down the M4 to Bath-Bristol and then will turn left down the M5 to Exeter, Plymouth and beyon. Alternatively the relatively 'depressed' regions will attract extra investment due to their 'attractiveness'- low wage rates,nice scenery or whatever. Regional economic convergence is just around the corner.

Pelkamns and Winters (1988) are in sympathy with this kind of viewpoint. "Regional problems are not a serious economic objection to the European Domestic Market". True one might not want to cancel '1992' but one surely must take account of its possible 'downside' implications.

If prices fall then the greatest gains will, ceteris paribus,benefit the high consumer as compared to the low consumer. The rich get richer and the poor get less poor. This law applies both to individuals and to regions. The benefits fall as rain whilst the costs strike as lightning! The branch plant will close. The 'peripheral' region may suffer a net loss that may not be wiped out by future pickings dispersing from the 'core'. Migration of the 'poor' to the 'richer' regions is not the answer. Such movements exacerbate the congestion in such as the South-East and reduce the appeal of the 'poorer' region such as the 'far 'South-West. An enhanced Regional Fund is appealing yet could ossify the current regional imbalances. The requirement of 'matching contributions' means that the 'poorer' the region becomes the less it is able to 'match' and hence gain benefit from the structural funds of the EC. The 'rich' get richer and the 'poor' get poorer? The disbursements of the Regional Fund in 1988 were 1.9 billions whilst those of the Social Fund amounted to 3.5 billions.

The regional effect of the Internal Market will depend on the precise form that the Internal Market ultimately takes and on the regional composition of production and consumption. The regional entrepreneurial reaction to 1992 is of singular importance. It has to be re-iterated that the "rich pickings", of the Internal Market, "have to be earned not inherited". As such, even if in the current environment, a sector is well established and prospering in the South-West the 'new' environment post-1992 may not ensure its continued survival.

A concentration of production may mean that less favoured regions are faced by less choice and have to put up with monopoloy exploitation. The centralisation of control, that will tend to accompany the concentration of production, will lead to the creation of 'branch-type' regions. Branches are always in line for pruning! The regions will, come 1992, become more suspect and vulnerable. The South-West might be closed down!

A whole panoply of strategic locational decisions will appear on the business agenda. Extrapolation, from the present into the future, does not always provide reliable forecasts. The time is now right for a major regional initiative to be undertaken given the underdeveloped state of the art.

How well placed is the South West to extract its share of the possible benefits? The benefits can accrue at the macroeconomic level- as the income effects of the expanded Europe-wide domestic market become available- and at the microeconomic level- as the sectoral regional, impacts are worked out. The regional impact is given by the summation of the two separate elements.

If the Internal Market programme does increase incomes by up to 7.5% in the most favourable scenario (Cecchini, 1988), can one expect the South-West to obtain a larger slice of the available cake? If the Internal Market does tend to re-inforce contemporary developments then the South-West should gain. See Figure 10 for relevant details.

FIGURE 10:
REGIONAL DEVELOPMENTS IN THE UK

Region:	Annual Growth '76 -'79 % GDP		Unemployment '79 -'86 %	Personal Disposable Income ('86) per Head
North	0.8	1.2	11.9	4410
Yorkshire	2.0	1.7	9.5	4508
East Midlands	2.6	2.2	7.3	4501
East Anglia	2.8	3.6	4.8	4771
South-East	3.2	2.5	5.1	5560
West Midlands	1.2	1.4	8.7	4303
North-West	2.1	1.1	10.6	4457
Wales	2.4	1.0	10.5	4138
Scotland	1.2	1.6	11.3	4614
South-West	3.6	2.7	6.4	4705

Source: Neuberger (1989)

In terms of growth the South-West had the best performance in the late 1970's period and the second best performance in the period up to 1986. Only East Anglia outperformed the South-West. This good growth performance is reflected in a low unemployment rate for the region. Only the South-East and East Anglia do better. If 'fortune favours the already fortunate' then the South-West should reasonably expect to perceive the Internal Market programme constituting an 'opportunity' rather than as a 'threat'. At the macroeconomic level it might be then argued that the enhanced future prosperity, within the EC, will tend to increase the degree of economic inequality that already exists.

In fact the benefits of the Internal Market will necessarily create costs which will impact on certain regions of the EC. Strangely the European Commission has not reported any studies of the presumed regional impacts. How will the 'richer' fare? How will the 'poorer' make out? Will the Internal Market magnify the economic disparities which already exist? The South-West could end up benefitting whilst other poorer regions lose out.

The argument of the European Commission (1987) is that the greater prosperity that the Internal market brings will speed up the process of 'economic convergence' whereby the 'poor' benefit from the beneficial spill-overs from the over-heated core. The 'poor' will, eventually, become as well off as the 'rich'.

The "new dynamism" of the Internal Market may need to be augmented by extra payouts from the various structural funds of the EC. The European Regional Development Fund, the European Social Fund and the European Guidance and Guarantee Fund are set to see the real value of their resources double between now and 1992. Danger signs have quite clearly been spotted.

The precise impact of the Internal Market will depend, of course, to a great extent on what is being produced, the spending power of the residents and its location. Will the Internal Market exacerbate or ameliorate regional imbalances? Rationalisation of production into larger units may well result in greater centralisation of functions towards the 'economic hub'- the 'golden triangle' of the EC. The threat to the more peripheral regions will arise from the possible relocation of key commercial activities to the more prosperous areas and regions. The case can be argued that the Channel Tunnel will facilitate and expedite this process.

What of the microeconomic effects? The relative importance of 'high-tech' activity in the South-West may lead one to conclude that Internal Market benefits might be 'earned'. Evidence from the European Commission on contracts awarded confirms that the UK is, with respect to public procurement, less restrictive than other EC Member States. The privatisation programme of the 1980's has undoubtedly resulted in greater openness in the tendering activity of those organisations loosely defined as being within the ambit of public procurement. In respect therefore of telecommunications and related services the stakes that will be played for will, no doubt, be quite considerable. The UK experience of 'liberalisation' and 'deregulation' in this sector means that the UK should enjoy a head start as greater openness, Community-wide, comes about. This 'high tech' benefit should be evident in the South-West.

Formal modelling of the regional impact of 1992 using the results of Smith and Venables (1988) and 'generalising' them (People's Economic Bureau) the Internal Market is seen to produce a UK job loss of 200, 000 with a marked burden falling on the heartland of England. Yorkshire, East Midlands, East Anglia, West Midlands and the North West suffer above average job losses. The South-West suffers most amongst the group of regions that suffer relatively least. See Figure 11 for details.

The South-West's share of the job losses is approximately 7%.whereas the South-West's share of UK jobs is some 6%. The burden borne by the South-West, in terms of unemployment, is 1% higher than an equal division of the 'misery' would allocate. Clearly other regions suffer much more.

FIGURE 11:
THE REGIONAL IMPACT OF THE INTERNAL MARKET

Region:	Output		Employment	
	%	£mn	Total '000	%
North	-0.8	-129	-8.4	-0.77
Yorkshire	-0.9	-201	-16.6	-0.92
East Midlands	-1.2	-176	-18.3	-1.20
East Anglia	-0.3	-97	-7.3	-0.91
Greater London	-0.5	-447	-18.6	-0.54
R o SE	-0.7	-560	-28.9	-0.79
West Midlands	-1.1	-227	-21.7	-1.05
North-West	-1.0	-285	-21.4	-0.95
Wales	-0.7	-112	-6.4	-0.74
Scotland	-0.8	-237	-14.1	-0.75
South-West	-0.8	-209	-12.5	-0.79
TOTAL		-2680	-174.2	

Source: People's Economic Bureau (1988)

In terms of the sectors, earlier categorised by importance of technical barriers to intra-Community trade, how will the South-West be affected by their removal? See Figure 12. Where the value of the location quotient exceeds unity that sector is relatively more important, in terms of employment, to the South-West than to the UK as a whole. When the location quotient is less than unity the importance to the South-West is less than for the UK as a whole. The pattern of location quotients is mixed.

It is the case though that in those sectors which, at the moment, face the highest barriers and are relatively important to the South-West- that is the location quotients exceed unity- tend to be large employers of labour, and hence implicitly, high output producers. Such is the case with Food, Drink and Tobacco, Mechanical Engineering, Precision and Medical Equipment. The location for another major employer, Electrical Engineering, is only marginally below unity. If these sectors prosper, post-1992, then the South-West should also prosper.

FIGURE 12:
IMPACT OF TECHNICAL BARRIERS ON UK INDUSTRY

	Employment UK '000	Employment SW '000	Location Quotient for SW
Barriers of Great Importance:			
Electrical Engineering	599.6	37.9	0.85
Mechanical Engineering	750.4	56.0	1.00
Pharmaceuticals	85.5	1.2	0.02
Food, Drink & Tobacco	587.8	50.5	1.15
Precision & Medical Equipment	104.2	16.5	2.65
Barriers of Medium Importance:			
Motor Vehicles	273.2	6.3	0.20
Non-Metallic Mineral Products	221.7	11.7	0.71
Metal Articles	331.1	15.1	0.63
Rubber Products	62.7	6.8	1.47
Office & Data Processing Equipment	85.7	3.3	0.50
Barriers of Low Importance:			
Chemicals (Non-Pharmaceuticals)	250.4	17.5	0.09
Other Transport Equipment	289.2	54.0	2.50
Leather & Leather Goods	22.1	1.9	1.20
Plastics	129.8	10.9	1.17
Production of Metals	192.5	3.2	2.10
Footwear & Clothing	292.4	17.6	0.81
Mineral Oil Refining *(figures not available)*	***.*	**.*	*.**
Paper, Printing & Publishing	481.6	30.8	0.84

Sources: Employment data from Census of Employment (1984)

Notes: Location Quotient = Regional Sectoral Employment Share as a proportion of UK Sectoral Employment Share.

Total UK Employment (1984)	20, 846, 000
Total SW Employment (1984)	1, 553, 000

Getting rid of the barriers will enable the relatively efficient sectors- those with relatively high trade penetration into the EC- to expand further. Certain elements within electrical engineering, pharmaceuticals, food, drink and tobacco, precision and medical equipment and, possibly, office and data processing equipment and non-metallic mineral products.

The strength that is enjoyed by the UK in the domain of financial services 'should' ensure that the UK comes out on top in the post-1992 world. Both banking and insurance are particularly well placed to take advantage of the liberalised Euro-market when the appropriate regulations have been adopted and applied by the Member States. The regional strength of a selection of the more important tradeable services is indicated by Figure 13.

The extent to which the South-West will benefit depends critically on the nature of the insurance and banking business undertaken. If the focus is essentially domestic, rather than international, then the impact of the Internal Market will be minimal. Recent evidence exists, though, that the South-West is being chosen, increasingly, as the site for 'head office' type developments and, as such, Internal Market gains are possibly in the 'offing'.

FIGURE 13:
SOUTH-WEST SERVICE EMPLOYMENT AND SERVICES LOCATION

	Regional Employment '000	Location Quotient for SW:
Banking	34.9	0.92
Tradeable Business Services	19.2	0.76
Insurance	23.4	1.41
Road Haulage	18.1	1.26

Source: Employment Census (1984)

Can the South-West exploit the 'mushrooming' markets of Spain and Portugal- the 'Iberian Connection'? After all the South-West is ideally positioned, relative to the rest of the UK, to make gains given the location of its maritime connections. The ports of Plymouth and Poole offer the opportunity for a speedier link up with the Iberian peninsula and 'Atlantic' France. One can optimistically expect enhanced prosperity for these two ports come the Internal Market. Chris Curtis, the South-West Regional Director of the Confederation of British Industry, writing in The Western Morning News recently pointed out that economic growth for Spain is predicted to reach 3.0% in 1989 with Portugal, reaching even higher, at 3.5%. These growth rates rather overshadow the anticipated 1.7% for West Germany and 1.5% for France.

Of course the combined national income of Spain and Portugal currently is only a tenth of that of the UK, whereas the combined national income of West Germany and France is three times that of the UK. In absolute terms the 'national cake' of West Germany and France together is still growing thirty times faster than the combined 'national cake' of Spain and Portugal! Whether or not Iberia is then the "key to success in the '92 Euro-scene"(Curtis, 1989) for the South-West is highly debatable.

Portugal is certainly an undeveloped market place, as far as the UK is concerned. Only 0.75% of UK exports to the European Community go to Portugal with about 5.0% going to Spain. It might be that '1992' is the kind of event that will spur the South-West to exploit the natural advantage of its location. In time as Iberia becomes more developed then the demand for capital goods and consumer goods from 'abroad' will undoubtedly increase.

During the financial year 1987-1988 a record amount of 'mobile investment' entered the South-West. In all nearly 30mn. was invested in the region. The USA led the way with six major investments that created some 660 jobs. The six included the Premier Computer Corporation of Oklahoma- the USA's biggest producer of disk drives, Becton Dickinson- a major player in the health care market and matrix software.

Record levels of activity are currently being reported by the Devon and Cornwall Development Bureau. Enquiries from both Japan and Europe are at all time highs with the 'high-tech' sector leading the way. The future appears to be bright. Overseas companies are obviously impressed by the commercial qualities evident in the South-West in this the run up to the Internal Market. The proof of the pudding appears to be in the eating!

Within the South-West there appears to be quite a number of potential sectoral beneficiaries of the Internal Market programme. Whether or not these 'rich pickings' are harvested is a moot point. The extent of current 'inward investment' would indicate that those who should know are placing their bets within the South-West. This is, undoubtedly, a most encouraging sign. One should not, however, go blindly overboard- blinded by the 'hype'- as encouraging signs may not always come to fruition.

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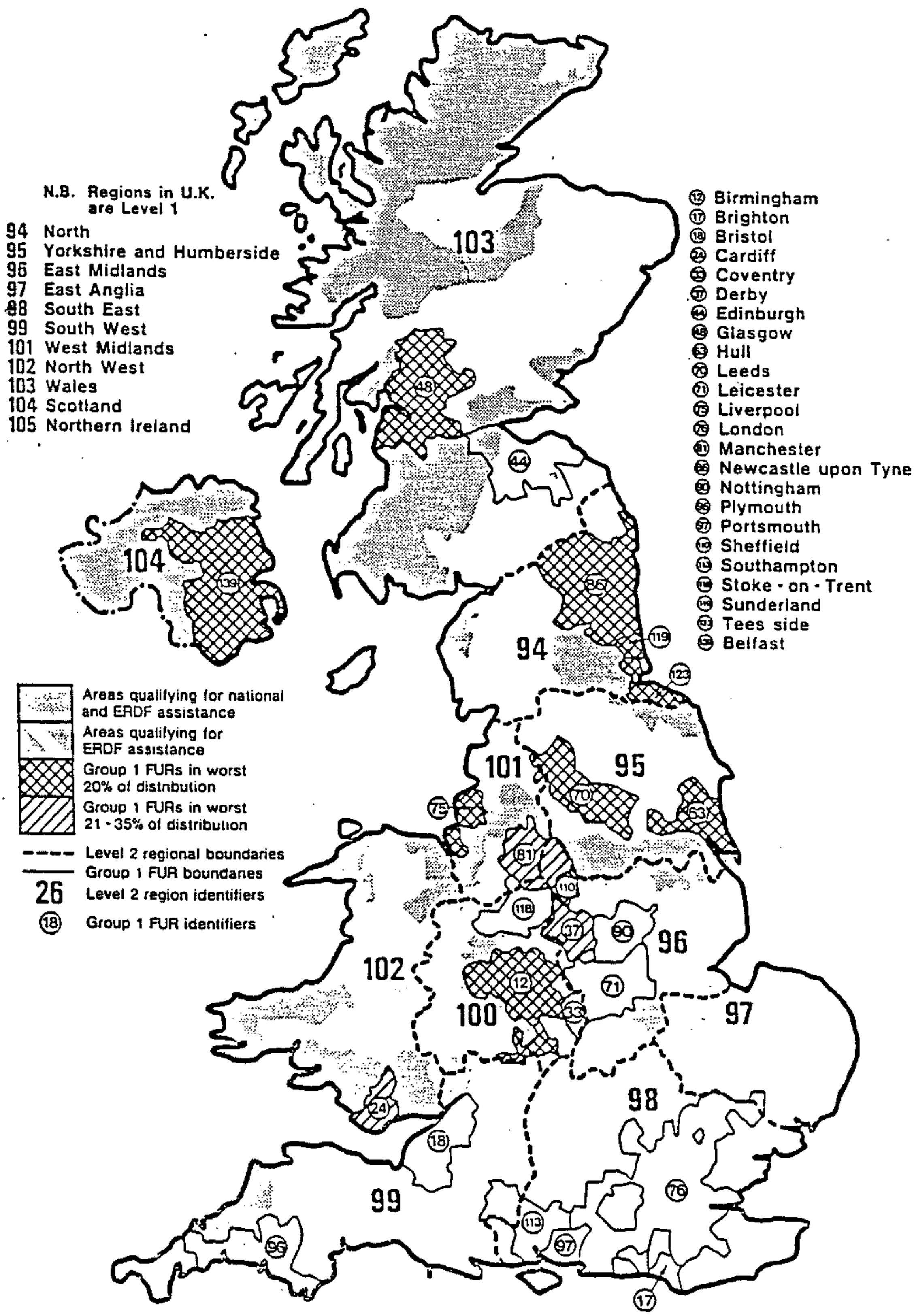
APPENDIX 1:
THE REGIONS OF THE UNITED KINGDOM



Source: Commission of the European Communities (1987)

APPENDIX 2:
THE REGIONS OF SPAIN AND PORTUGAL

Source: Commission of the European Communities (1987)